STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:

San Diego County, California; Appropriations; General Obligation

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Summary:

San Diego County, California; Appropriations; General Obligation

Credit Profile		
US$92.71 mil rfdg certs of part ser 2014A due 10/15/2029		
Long Term Rating	AA+/Stable	New
US$2.08 mil rfdg certs of part ser 2014B due 10/15/2029		
Long Term Rating	AA+/Stable	New
San Diego Cnty GO Pension		
Long Term Rating	AA+/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	Current

Rationale

Standard & Poor's Ratings Services affirmed its 'AAA' issuer credit rating (ICR) on San Diego County, Calif. At the same time, we assigned our 'AA+' rating to the county's 2014A and 2014B refunding certificates of participation (COPs). We also affirmed our existing ratings on the county's COPs, lease revenue bonds, and pension obligation bonds (POBs). The outlook is stable.

The county's general obligation (GO) pledge, not an unlimited ad valorem tax levy, secures the POBs. The COPs and lease revenue bonds are secured by pledged lease revenues, subject to abatement in the event of damage, destruction, or impairment of the leased assets.

The COPs represent an interest in base rental payments by the county, as lessee, to the trustee, as lessor, for the use of the Edgemoor skilled nursing facility. We understand that the county intends to use the COP proceeds to refund existing COPs series 2005 and 2006. Under the lease agreement, the county has covenanted to annually budget and appropriate base rental payments. Lease payments are triple net, without right of set-offs, and the county is responsible for the maintenance, taxes, and utilities of the leased property. The county can abate payments in the event of damage to, or the destruction of, the assets. To mitigate the risk of abatement in such a case, the county has covenanted to maintain at least 24 months' rental-interruption insurance coverage. In addition, leased assets meet the seismic risk standards under our criteria. For the county's 2014 refunding bonds, the county will set aside the annual lease payments three months prior to the debt service payment and in addition, hold a reserve equal to 50% of maximum annual debt service (MADS).

The rating reflects our assessment of the following factors for the county.

- Very strong economy, bolstered by a sizable, deep, and diverse economy with a favorable location that exhibits relatively stable assessed valuation (AV), coupled with strong wealth;
- Very strong budgetary flexibility with 2013 available reserves equal to about 26% of expenditures, including reserves for emergency contingencies;

- Strong budgetary performance, with the general fund posting at least slight surpluses for the past three years;
- Very strong liquidity providing very strong cash levels to cover both debt service and expenditures and extremely strong market access;
- Very strong management conditions with strong financial policies; and
- Strong debt and contingent liabilities position.

Very strong economy

San Diego County, with a population estimate of 3.1 million, has a diversified economy based on tourism, international trade, military, and high-technology manufacturing. County unemployment continues to decline and was 7.5% for calendar year 2013, down from the 2012 level of 8.9%. Leading employers include the government, education, military, and health care sectors, all of which, in our opinion, are very stable. The county has projected per capita effective buying income of 111% of the U.S., while per capita market value was $127,000 for fiscal 2013. Assessed values (AVs) have strengthened over the past year, growing 3% in fiscal 2013-2014 over the past year to $405 billion. Management noted that 2014-2015 is showing even stronger growth at about 6% over the previous year. Looking further ahead, management is projecting growth of about 3% for fiscal 2015-2016. Growth in AV has in part reflected Proposition 8 restorations, increases in the median home prices, and slight increases in sales and new construction activity.

Very strong budget flexibility

In our opinion, the county's budgetary flexibility remains very strong, with available reserves at 26% of general fund expenditures for fiscal 2013, when including reserves committed for emergency contingencies. The county's reserve policy ensures a minimum 17% of reserves will be available for contingencies. Management has consistently met and exceeded its reserve policies, which require the maintenance of 10% of general fund minimum unassigned fund balance for economic uncertainty, 5% for unforeseen catastrophic events, and 2% for contingencies. In addition, the county has a history of what we regard as conservative budgeting. Expenditure controls have helped maintain positive operations, which are necessary due to the county's limited direct revenue-raising flexibility. Management has consistently met its reserves policies and the county's projections for fiscal year-end show an increase in reserves for both total and unassigned reserves. Furthermore, third-quarter results are often conservative and it is likely reserves will end higher than currently estimated. We do not anticipate any weakening of budgetary flexibility.

Strong budgetary performance

In our opinion, finances remain strong with audited 2013 posting close to a 3% surplus for the general fund and a surplus in the total governmental funds as well. We expect that the county's financial performance will remain strong. The county anticipates adding to its fund balances for fiscal 2014.

For fiscal 2015, management is projecting 0.25% growth over the previous year's budget. The budget assumes 4% revenue growth in AV for budgetary purposes, which, given current estimates, is conservative. The implementation of the Affordable Care Act will also affect the county's finances. Historically, the county received revenue from the state to support health care costs for low-income and indigent care. With the movement toward Medi-Cal expansion, the county will be receiving less revenue from the state for these costs, but also incur fewer costs. For fiscal 2014, the costs are about half of 2013 costs and projected to decline substantially for fiscal 2015. While some counties that maintain hospitals have more of a push-and-pull with expenditures and revenues under the ACA implementation, management noted that San Diego County will not have any additional costs due to ACA and thus the implementation should have no negative effects and currently even appears to have positive financial implications to date.

Very strong management conditions

We view the county's management conditions as very strong with "strong" financial management practices under our Financial Management Assessment methodology, indicating practices are strong, well embedded, and likely sustainable. The county has written policies that cover investments, swaps, and debt management. Its reserve policy requires reserves of no less than 17% of discretionary revenues. Both investment results and actual-to-budget variances for general fund revenues and expenditures are reviewed monthly. The county uses various external and internal resources to generate budget assumptions, including various economic publications and its own historical trend analysis. The county also engages in multiyear financial planning, and its capital plan spans five years and fully identifies potential sources and uses of funds. Management usually makes conservative assumptions about revenue growth and somewhat less conservative assumptions about expenditure growth, with a resulting pattern of annual operating surpluses.

Very strong liquidity

Liquidity is very strong, providing very strong cash levels to cover both debt service and expenditures. In addition, we believe the county has extremely strong market access, having issued lease revenue bonds, COPs, and tax anticipation notes frequently. We expect a consistent level of liquidity in future years. Internal liquidity has strengthened this year

Strong debt and contingent liability profile

In our opinion, the county's debt and contingent liability profile is strong with total governmental fund debt service at 4.3% of total governmental fund expenditures and net direct debt at 43% of total governmental fund revenue, based on audited 2013 numbers. The 2014 refunding bonds will provide annual savings and will mature one year earlier than the existing bonds.

The county continues to address its pension obligations. It has its own pension plan called the San Diego County Employees Retirement Association (SDCERA). The county paid above the annual required contribution (ARC) in fiscal years 2005 to 2007, in fiscal 2011, and fiscal 2013to address the decline in the funded level. We understand the county has revised the pension program's assumed rate of return downward to 7.75% from 8.0%. According to county estimates, the pension plan is 79% funded for fiscal 2013.

Beyond contributing to the pension fund, county officials restructured the pension plans and created a different tier of benefits they believe will likely decrease costs. In addition, we understand that the county estimated its other postemployment benefit (OPEB) unfunded actuarial accrued liability was $180.2 million and that officials are currently paying the OPEB ARC.

The ARC for the county's pension programs and the OPEB contribution are equal to 8% of governmental fund expenditures.

Strong institutional framework

We consider the Institutional Framework score for California counties with $500,000 or more in federal awards expended a year and two or more federal programs strong.

Outlook

The stable outlook reflects Standard & Poor's opinion of San Diego County's deep and diverse economy, strong reserves, formal policies, manageable debt, and conservative budgeting, where actual results typically exceed projections. We do not expect to lower our rating within the outlook's two-year horizon based on our belief that management will likely maintain good finances and reserves. Given management's track record and the anticipated strengthening in revenues, we do not see downward rating action as likely for this credit over the two-year outlook horizon.

Related Criteria And Research

Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007

Related Research

Institutional Framework Overview: California Local Governments

Ratings Detail (As Of August 1, 2014)		
San Diego Cnty certs of part ser 2011 due 02/01/2042		
Long Term Rating	AA+/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	Current
San Diego Cnty certs of part (Cedar & Kettner Development Project Parking Structure) due 02/01/2042		
Long Term Rating	AA+/Stable	Affirmed
San Diego Cnty rfdg COPS due 11/01/2019		
Long Term Rating	AA+/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	Current
San Diego Cnty taxable pension oblig bnds (Cap Apprec Bnds) ser 2004C dtd 06/29/2004 due 08/15/2009-2015		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
San Diego Cnty COPS (Justice Facilities Rfdg)		
Long Term Rating	AA+/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	Current
San Diego Cnty ICR		
Long Term Rating	AAA/Stable	Affirmed
San Diego Cnty Pension Obligation Ref bnds (Fixed Rate) ser A		
Long Term Rating	AA+/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	Current
San Diego Cnty certs of part (North & East Cnty Justice Facs Rfdg) ser 2005		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
San Diego Cnty certs of part (2005 Edgemoor Proj & 1996 Regl Comm Sys Rfdg) ser 2005		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

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Ratings Detail (As Of August 1, 2014) (cont.)		
San Diego Cnty COPs (Edgemoor II Proj) ser 2006		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
San Diego Cnty GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
San Diego Cnty GO pension		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
San Diego Cnty GO pension (XLCAPITAL)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
San Diego Regl Bldg Auth, California		
San Diego Cnty, California		
San Diego Regl Bldg Auth (San Diego Cnty) lse rev bnds (Cnty Ops Ctr & Annex Redev Proj) ser 2009A		
Long Term Rating	AA+/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	Current

Many issues are enhanced by bond insurance.

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